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CAN THE EGYPTIAN ECONOMY AFFORD THE SOVIET BLOC ARMS DEAL?[1]

Thanks to Egypt's strong foreign exchange position, the regime will encounter little difficulty in the short-run in financing an arms deal with Czechoslovakia to the value of £E 30,000,000 (US $86,000,000). If present trends continue, however, the Egyptian economy, now largely dominated by a single crop, cotton, could become increasingly subject to Soviet economic leverage: barter agreements have already made the Communist bloc the largest purchaser of Egyptian cotton (France is second) and Egypt now has, in addition, a Soviet offer of a two percent loan for the High Aswan Dam, to be repaid in cotton. The advantage Egypt sees is that with the equivalent of $86,000,000 in cotton and rice, Egypt is apparently obtaining well over $150,000,000 in aircraft, tanks, motor torpedo boats, and submarines. By drawing most of its heavy military equipment from Czechoslovakia, it will, however, be increasing its military dependence on the Soviet bloc. Whether the USSR could actually employ this dependence as political leverage would, of course, depend on whether Egypt could readily switch its trade to the West in an emergency.

Egypt has large foreign exchange reserves. As of July 29, 1955 total foreign exchange and gold holdings amounted to £E 259,800,000 (US $746,000,000), as follows:

1. This Intelligence Brief is the product of additional research undertaken after the publication of IR-7053, The Soviet-Egyptian Agreement: Reactions and Implications, September 27, 1955, SECRET, and supersedes a paragraph on Egyptian financial capabilities contained therein.

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	Gold and Foreign Exchange July 29, 1955 (in LE millions)
Sterling Number 1 Account	43.3
Sterling Number 2 Account	129.9
Gold	60.6
United States dollars	12.4
Other currencies	13.6
Total	259.8

An additional LE 5,000,000 was transferred from the Sterling Number 2 (blocked) Account to the Number 1 (immediately utilizable) Account on September 2. In accordance with the Anglo-Egyptian agreement, the entire blocked sterling balance will have been released by the end of 1963. These exchange holdings are a major financial resource of the country, and, as such, they constitute a vital factor in Egypt's development program. In the short-run, however, institutional factors, such as the absence of an effective coordinating agency, will doubtless tend to limit outlays for development. Therefore, it is clearly feasible for Egypt to draw down exchange balances in the meantime in connection with the purchase of arms.

On the fiscal side there is likewise no short-run hazard in paying for the military equipment. Although there is no specific provision in the 1955/56 budget estimates for such an expenditure, existing legislation would presumably permit financing through issuance of Treasury Bills. Egypt could utilize its still ample holdings in foreign exchange to make sufficient imports available to offset the possible inflationary effect of such deficit financing.

During the current marketing year, Egypt has encountered serious difficulty in selling its cotton. Barter agreements with the Sino-Soviet bloc countries have somewhat alleviated this problem. During the 1953/54 marketing year (beginning September 1, 1953) these countries took only about nine percent of Egypt's cotton exports, but in the corresponding 1954/55 period they took 22 percent. Because of the continuing poor outlook for selling cotton, the opportunity of trading cotton for arms must seem especially attractive. Egyptians may reason that surplus cotton which might otherwise have remained unsold is being taken off the farmers' hands.

Thus in the short-run the arms agreement is not likely to put a serious burden on the Egyptian economy. The outlook for the long-run, however, is much less satisfactory. Egypt's serious economic plight is common knowledge. Per capita income, which approximated $125 in 1950, fell to $112 in 1953 and is still falling. To arrest this trend and reverse it if possible is the major internal objective of the Nassir regime. Accordingly, various development projects have been approved, involving both land reclamation and industrialization. The key project is the High Aswan dam, which may add about 1,500,000 acres to the 6,000,000 acres now under cultivation. While cost figures for Egypt's development projects remain tentative, the International Bank for Reconstruction and Development estimates that they would aggregate about $1.2 billion over the next ten years, of which $850,000,000 would be for the dam.

Despite Egypt's large reserves of foreign exchange, financial resources available for development are limited. While there are no means of measuring accurately the extent of these resources over the next ten years, the following estimates of the International Bank for Reconstruction and Development (in US dollar equivalents) seem reasonable:

	US$ million
External resources	
Borrowing of foreign exchange deposits in the Egyptian National Bank (minimum)	287
Foreign assistance (speculative	100
Sub total	387
Domestic resources	
Regular budget resources	72
Public loans	431
Extraordinary resources (royal treasures of King Faruk and funds temporarily available from excess cash balances and sales in the land reform program)	100
Sub total	603
Total	990

These figures indicate a deficiency of over $200,000,000 in realizing the development objectives. Obviously, unless additional resources can be found, some projects may have to be either cancelled or postponed. In the long-run, an arms purchase of $86,000,000 will add to this deficiency.

In recent years there have been near-chronic deficits in the Egyptian balance of payments. The financing of these deficits has necessitated some drawing against foreign exchange reserves. Within the past six years small surpluses were attained in only 1949 and 1954. Current indications point to a deficit of LE 15,000,000 (US$43,000,000) in 1955. An adverse trade balance is the major factor in Egypt's balance-of-payments problem. Continued sizeable deficits in ordinary balance-of-payments accounts will adversely affect Egypt's foreign exchange position, and its trading of cotton for arms instead of foreign exchange is bound to add to the adverse consequences for Egypt's development program. To use its resources to buy arms will thus jeopardize full realization of the regime's long-run objectives.

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